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UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION
Vienna International Centre, P.O. Box 300, 1400 Vienna, Austria
Tel: (+43-1) 26026-0 · www.unido.org · unido@unido.org

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THE CAPITAL MARKET IN JAPAN

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The Nomura Securities Co., Ltd.
61 Broadway, New York, N.Y. 10006
Head Office, Tokyo

The opinions expressed in this paper are those of the author and do not necessarily reflect the views of the United Nations Industrial Development Organization.

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THE CAPITAL MARKET IN JAPAN

SECTION I - SUMMARY

The Japanese capital market has developed rapidly over the past decade. Net new securities issued in 1965 totaled 1,896 billion yen[1] and were more than eightfold the amount issued in 1955. In the recent five years to 1964, net new securities increased at an annual compound rate of 21 percent. During this period, increases in corporate bonds and stock were relatively small, whereas Government guaranteed bonds and municipal bonds showed notable growth. In fiscal 1965 (April '65-March '66) Japanese Government, for the first time in the post-war period, started to offer publicly its long-term bonds in the domestic market. During fiscal 1965 and 1966, 1,175 billion yen was offered and, as a result, the relative importance of the public sectors as issuers in the capital market greatly increased. Recently investments in plant and equipments by the private sector is recovering and the heavy public borrowing poses a problem as it preempt the supply of savings from private industry.

Despite this notable growth in debt securities, bond trading on the organized exchange is almost nil. Even the trading on the over-the-counter market is very small and thin mainly because more than eighty per-cent of total debt securities are purchased and held by financial institutions. An effort to promote sales of bonds to individual has recently been launched by securities companies on the occasion of the new Government bonds issue. But limited marketability seems to be the largest obstacle in the effort to expand bond ownership.

With the experience of severe inflation right after the war, there is still a tendency for Japanese savers to keep their savings in more liquid forms. A substantial part of savings, instead of being channeled directly to the market, is now being held in the form of bank deposits and savings accounts. High popularity of one-year maturity discount bank debentures issued by long-term credit banks also indicate a preference for liquidity by individual savers. The very small difference between return to the investor on short-term and long-term investments and favorable tax treatment of interest income is quite influential in the flow of funds to the capital market.

Historically, banks wield enormous power in Japan's capital market. The aggregate balance sheet of 628 companies as of March 31, 1966 indicates that bank loans are financing 36.5 percent of the total assets. Further, banks and quasi-banks purchased 82.5 percent of new corporate bond issues in 1965 and have common stock investments of 656 billion yen at book value in their own accounts.

Note 1. The par value of the Japanese yen is 360 to $1.

The stock market, measured by "Dow Jones" index of 225 leading stocks, soared from a low of 85 in 1950 to a peak of 1,829 in 1961. Business recession, profit squeeze of industrial companies due to keener competition and reaction of excess speculation on the market combined to lead to the prolonged stagnation of stock market since 1962. A series of financial upsets and a deepening recession further depressed stock prices to nearly 1,200 in 1965. To prevent further erosion of business and investor confidence, two stock pooling organizations were set up and they bought approximately 428 billion yen valued stock with a huge loan from the Bank of Japan.

With better business, the index has recovered to more than 1,400 recently. The two pooling organizations have unloaded a part of their shelved stocks during the recovery process. They however, still hold substantial portions and confidence among investors is adversely affected by the existance of the pooling organizations.

Total demand for long-term funds on the capital market is expected to increase continuously in the future. Demand from private enterprises, however, will slow down for a while since they have already invested heavily in expansion and modernization of plant and equipment and depreciation charges will maintain a high level. Public sector, on the other hand, will neet to step up their call on the capital market as repletion of social overhead capital is a rather urgent matter in Japan.

Solution of the present capital market problems will require a series of actions which will restore the confidence of savers and investors. Expansion of the width of the securities market and improvement of the efficiency of the market are also important. The Government, which will need the facilities of the capital market more than ever, took up recently the reform of the securities market as an essential part of its economic policies. Securities companies are also endeavoring to channel excess liquid assets and new savings into long-term investment by various ways including the development of an attractive variety of securities, making markets for Government and corporate bonds and by introducing better and efficient stock exchange practices.

SECTION II - THE PATTERN OF SAVINGS AND INVESTMENT

Japan's rapid economic growth in the past years has been due in large measure to the high level of gross fixed investment throughout the period. In 1951, the proportion of GNP devoted to this purpose amounted to about 20 percent and the record was achieved in 1961, when gross fixed investment amounted to 35 percent of GNP. It now stays around 33 percent.

Table 1 shows the relationship between net new securities issues and aggregates of GNP and gross fixed investment. The importance of new securities issues as a source of investment finance will in part indicate the fact that Japanese companies have less ability to satisfy their financial requirements from their own resources. Increase of floatation of Government and Government guaranteed securities in order to meet heavier investment in public works is also reflected in the high ratio.

Table 1 Gross fixed investment and new securities issues

(Billions of yen)

	GNP Current Price (1)	Gross Fixed Capital Formation (2)	Percent Of GNP (3)	Net New Securities Issues (4)	Percent Of Investment (5)	Percent Of GNP (6)
1951	5,437	1,101	20.3	157	15.7	2.9
1955	8,785	1,794	20.4	227	12.7	2.6
1960	15,928	5,124	32.2	1,045	20.5	6.6
1961	19,274	6,785	35.4	1,769	26.4	9.3
1962	21,052	7,227	34.4	1,418	19.8	6.8
1963	24,689	8,259	33.5	1,585	19.3	6.5
1964	28,236	9,282	33.0	1,857	20.0	6.5

Sources: "Annual Report on National Income Statistics 1966"
Economic Planning Agency
"Economic Statistics of Japan 1965"
The Bank of Japan

New security issues (net) in the period 1960-64 have provided on the average 20-27 percent of the funds for gross fixed investment and fixed interest securities have represented about half of the new securities issued in this period. If stock issues of unlisted companies are excluded in order to give compatible figures with bond issues (corporate bonds are issued by only large listed companies), fixed interest securities occupy more than two-thirds of total issues.

The relative importance of the public sector as issuer has been increasing in the past several years. The ratio of net public sector issues to total net securities issues increased from 14.6 percent in 1960 to 24.7 percent in 1964. The ratio increased sharply since 1965 when the Government started to issue domestic government bonds on a full scale. It has issued 500 billion yen in fiscal 1965 and 675 billion yen in fiscal 1966.

Table II Main components of gross fixed investment

(Billions of yen)

	1960	1961	1962	1963	1964
Private	3,845	5,054	5,021	5,773	6,551
Government	1,279	1,731	2,206	2,487	2,731
(Breakdown by industries, Agriculture, forestry and fishing	278	367	367	434	457
Mining, manufacturing and construction	1,882	2,515	2,219	2,409	2,735
Transportation, Communication and public utility	979	1,250	1,369	1,493	1,590
Housing construction	702	851	1,015	1,283	1,498
Public works	766	972	1,253	1,386	1,574
Other	518	830	1,004	1,255	1,423
Total	5,124	6,785	7,227	8,259	9,282

Source: "Annual Report on National Income Statistics, 1966" Economic Planning Agency.

Table III New security issues net of redemption

(Billionsof yen)

	1960	1961	1962	1963	1964
Share (Listed shares)	516 (324)	978 (609)	781 (519)	665 (351)	853 (464)
Bonds	529	791	637	920	1,004
Issued by:					
Government (Central & local)	24	17	9	77	100
Government agency	122	177	225	305	341
Long-term credit bank	231	211	269	373	410
Private enterprise	152	386	134	165	153
Total	1,045	1,769	1,418	1,585	1,857

Source: "Economic Statistics of Japan 1965"
The Bank of Japan

As table IV shows, approximately 50 percent of all new fixed interest securities issued have been purchased by banks. If bank debentures which individuals like were excluded, banks purchased almost 90 percent of fixed interest securities in 1964 (1960 was a rather unusual year because mutual funds specializing in bonds started during the year and as a result demand for corporate bonds was good due to the good public reception for the funds. This demand enabled industrial companies to issue an unusually large amount of bonds). As of the end of 1965, 76 commercial banks hold approximately 50 percent of the outstanding publicly offered fixed interest securities and these investments represented about 15 percent of the total deposits. Historically, Japanese banks have close relationship with industrial companies through equity ownership. Their investment in corporate bonds may be explained as a different form of loan.

Individuals favor discount bank debentures mainly because of short maturities (one year) and attractiveness of interest which is a bit higher than one year time deposits.

Table IV New debt security issues and subscribers
(Public offering only)

(Billions of yen)

Fiscal Year	1960	1961	1962	1963	1964
Subscribed by banks					
Gov.guaranteed bonds	64	69	95	138	160
Municipal bonds	19	20	30	38	43
Corporate bonds	164	115	159	234	219
Bank debentures 1.	144	211	242	304	337
Total	391	415	526	714	759
Subscribed by insurance cos.					
Gov.guaranteed bonds	1	1	1	4	11
Municipal bonds	0	0	0	2	3
Corporate bonds	3	1	1	2	2
Bank debentures	4	6	8	10	12
Total	8	8	10	18	28
Subscribed by mutual funds					
Gov.guaranteed bonds	6	6	6	6	6
Municipal bonds	2	2	0	0	0
Corporate bonds	174	63	0	0	0
Total	182	71	6	6	6
Subscribed by individual & others					
Gov.guaranteed bonds	1	6	0	0	2
Municipal bonds	3	1	0	0	1
Corporate bonds	39	9	10	33	27
Bank debentures	364	395	456	578	705
Total	407	411	466	611	735
Total subscriptions					
Gov.guaranteed bonds	72	81	102	148	179
Municipal bonds	24	24	31	41	47
Corporate bonds	381	188	171	269	249
Bank debentures	512	612	705	892	1,054
Total	988	905	1,009	1,350	1,529
% Subscription by banks to total issues					
Gov.guaranteed bonds	89.1	84.4	93.4	93.4	89.6
Municipal bonds	80.5	85.1	98.4	92.8	78.3
Corporate bonds	43.1	61.2	93.1	87.0	88.1
Sub Total	52.0	69.4	93.5	89.5	89.0
Bank debentures	28.0	34.5	34.3	34.1	32.0
Total	39.6	45.9	52.6	52.9	49.6

Note 1. Bank debentures are issued by three private long-term credit banks.

Source : Ministry of Finance.

Table V Shareownership in listed companies

(Million shares)

End of Fiscal Year	1960	1961	1962	1963	1964
No. of listed company	785	832	877	838	825
Gov't & public inst.	67	85	116	155	140
(%)	(0.20)	0.18)	(0.20)	(0.24)	(0.19)
Financial Insts.	10,352	14,832	18,690	21,247	23,406
(%)	(30.62)	(31.19)	(32.21)	(32.59)	(31.07)
(Mutual funds) [1]	(2,590)	(4,380)	(5,748)	(6,7[illegible]1)	(6,436)
(%)	(7.53)	(9.21)	(9.[illegible])	(10.28)	(8.54)
Securities firms	1,279	1,260	1,340	1,362	3,433
(%)	(3.72)	(2.65)	(2.32)	(2.09)	(4.56)
Other company and inst.	6,123	8,414	9,701	11,060	13,141
(%)	(17.8)	(17.69)	(16.72)	(16.96)	(17.44)
Foreign corp.	367	633	833	1,164	1,203
(%)	(1.07)	(1.33)	(1.44)	(1.78)	(1.60)
Individuals, and others	15,930	22,170	27,167	30,056	33,765
(%)	(46.32)	(46.63)	(46.80)	(46.08)	(44.82)
Foreigner	93	157	178	171	241
	(0.27)	(0.33)	(0.31)	(0.26)	(0.32)
Total	34,394	47,551	58,030	65,215	75.330
	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)

Note 1. Including holdings of Japan Joint Securities Co., a pooling organization set up early 1964.

Source: Ministry of Finance.

SECTION III - THE DEMAND AND THE SUPPLY FOR CAPITAL

BUSINESS SECTOR

Investment

Starting from 1956, Japanese industry invested heavily in plant and equipment for technological renovation and modernization purposes. Keen competition among companies accelerated investments. The fixed investment in the business sector came to occupy nearly a half of Japan's total investment in the late fifties. It has calmed down in recent years.

The portion of Japanese GNP devoted to gross fixed investment in the private secotr (excluding housing construction) hit a high of 17 percent in 1957. In the past five years to 1964 the average has decreased to 9.4 percent. During this eight-year period, (1958-1964) investments in such industries as household appliances, automobile, industrial machinery, metallurgy, chemical, electric power and pulp and paper increased considerably.

Industry's recourse to the securities market for investment funds during 1960-62 was quite heavy as the stock market was booming and mutual funds poured money into the market. The rush of new stock issues in this period indirectly led to the collapse of the market in 1965.

Savings

In the past ten years until 1964, savings of the business sector (depreciation and retained earnings) accounted for more than one-third of the nation's gross savings, and retained earnings has occupied 20 percent of net savings. Although retained earnings fluctuated widely according to general economic conditions, depreciation has continuously increased reflecting the high pace of equipment investment.

Japanese industry has been financing more than two-thirds of fixed investment from such internal savings. Depreciation has been playing an increasingly important role as a source of capital and in the last three years of the period, depreciation alone financed 39 percent of the total fixed investment. The rate of self financing to total fixed investment declined to the level of 60 percent in 1957-58 and in 1961-62 when investment was quite active. Recently, however, it came back up to approximately 80 percent but it is still low compared with other developed countries. Thus 20 to 40 percent of fixed investment or 30 to 50 percent of total investment (including inventory investment) had to be financed through the capital market or directly from financial institutions.

Table VI · Sources of investment finance

(Business sector) (Billions of yen)

	1960	1961	1962	1963	1964
Total investment 1.	3,060	4,894	3,949	4,302	5,278
Plant and equipment	2,529	3,608	3,547	3,494	4,282
Inventory	531	1,286	402	818	996
Total savings	1,861	2,421	2,365	2,885	3,385
Retained earnings	978	1,190	969	1,210	1,266
Depreciation	883	1,231	1,396	1,675	2.119
External financing	2,841	4,234	3,903	5,532	4,649
Bond issues	153	386	133	164	153
Share issues	550	964	772	587	740
Loans	1,931	2,496	2,804	4,226	3,422
Others	208	388	194	515	335

Note 1. National income statistics from 1951 to 1964 were revised in 1965 by Economic Planning Agency. As the total investment are based on Gross National Expenditure before revision, figures do not necessarily correspond with base figures of investment in table I and II which are based on the revised statistic.

Source: Ministry of Finance.

As table VI shows, three quarters of the total funds financed externally were loans from financial institutions in 1964. The portion of loans varies from 59 percent to 89 percent in the past ten years and it averaged at 77 percent. Stock and bond issues, on the other hand, financed only 22 percent on average. In 1961 when stock market was booming and mutual funds gained popularity and functioned to pump new money into the market, new issues recorded the historic volume of 1,350 billion yen. In that year stock and bond issues financed 32 percent of the total external fund requirements.

Since then the stock market slumped and stock issues have been tapering off. As easy money policy was adopted by the Government, bond issues and loans have been increasing steadily. Consequently, the portion of debt in the aggregate balance sheet of Japanese industry sharply went up. In 1966 the average equity-debt ratio declined to below 20 percent.

GOVERNMENT SECTOR

In Japan, Government expenditures (including local Governments) are approximately 19 percent of GNP, relatively low when compared with other developed countries. But the weight of

Government investments is much larger and 27 percent of total investment derives from the public sector.

Public investment demands have been increasingly heavy during the ten year period ended in 1964, with total investment expenitures by the government increasing from 753 billion yen to 2,813 billion yen (see table VII). This increase was possible primarily as a result of the central Government's surplus of current revenue over current expenditure during the period. In 1966, however, corporate income revenue had declined sharply because of a severe recession and the Government had to change its fiscal policy. During fiscal 1965 and 1966, Government sold domestic bonds (7 years maturity) in the amount of 1,175 billion yen. The high liquidity of credit institutions deriving from the very low level of private investments and the lowering tendency of interest rates helped the sale and 77 percent of total issues were directly placed with banks and insurance companies. Because of government's commitments for social development, housing construction and other long-term plans, it is likely that the Government will continue the floatation of Government bonds. When private investment does revive, Government bond issues will strain the money and capital markets as the liquidity of banks will be reduced and as the bond market is still so thin and limited.

Besides taxes, the central Government collects money through postal deposit, postal insurance and postal pension. Recently social insurance is increasing its importance as a source of investment capital. Most loans and investments are directed, partly through Government finance agencies, to public works, to local Governments and to the special private sectors such as small size enterprises and fishery and agricultural industry. Amount of such loans and investments corresponds to approximately 20 to 30 percent of total loans and investments of private financial organizations. Both public corporations and local Governments issue their own bonds. Local Governments especially are becoming more dependent on bond issues and loans from banks.

Table VII Sources of investment finance

(Public sector) (Billions of yen)

	1960	1961	1962	1963	196[illegible]
Total investment	1,262	1,564	2,129	2,392	2,8[illegible]
Total savings	1,150	1,688	1,831	1,940	2,0[illegible]
(Surplus in general account)	(1,040)	(1,539)	(1,676)	(1,765)	(1,8[illegible]
Financing	586	455	1,024	1,218	1,5[illegible]
Short-term Gov. bill	26	-268	890	116	2[illegible]
Gov. bonds	-	4	-20	-1	[illegible]
Municipal & Gov.agency bonds	125	181	223	319	[illegible]
Loans	115	181	297	306	[illegible]
Currency	11	9	8	16	[illegible]
Postal and other savings	151	160	223	279	[illegible]
Others	158	187	205	183	[illegible]

Source: Ministry of Finance.

INDIVIDUAL SECTOR

The average ratio of individual savings to private disposable income has gradually increased since 1953 and it reached 20 percent in 1961. Although the ratio declined to around 17-18 percent thereafter. the marginal propensity to save is still exceeding 20 percent; Among many reasons why the savings rate is high, the following are considered to be the principal ones. 1) The diligence of the Japanese by nature and a high standard of education. 2) A relatively limited social security system which encourage individual to save for the future 3) The amount of monetary assets held by individuals is relatively small compared with other developed countries (As shown in table IX the outstanding amount is only 139 percent of yearly disposable income). This high saving rate which could meet the active investment demand of industry supported the high growth rate of the Japanese economy.

The total investment of the individual sector (housing construction and both equipment and inventory investment of proprietorships) is steadily increasing. Especially new house construction is growing fast. The investments of this sector is less flexible to economic conditions and accounts for 15-20 percent of the nation's total investment. As only 40 percent of individual savings can finance total investment in the individual sector, the remaining 60 percent are invested in monetary assets.

When the composition of monetary assets is examined, it is clear that individuals prefer indirect investment such as bank deposits to direct savings (securities investment). In 1954 indirect investment occupied 75.2 percent of the total other than currency and demand deposit. Although the ratio declined to 46.8 percent in 1960 when mutual funds attracted personal savings; recently it has come up gradually toward the level of 1954.

Among securities held by individuals, investments in bank debentures have increased fastest in the past ten years to 1964 with annual compount rate of 40 percent. The annual increase rate, however, tapered off to 28 percent in the recent five years. Most of the bank debentures held by individuals are those of one year maturity and this can be regarded as another form of savings deposit. As table IX indicates, the aggregate amount of saving deposit and bank debenture is approximately 2.4 times of aggregate amount of securities investment including stocks, bonds and mutual funds. Mutual funds holdings which increased quite rapidly till 1961 have leveled off recently. Common stock holdings has increased at the annual compound rate of 6 percent in the past ten years to 1964.

Table VIII   Applications of personal savings

(Billion of yen)

	1960	1961	1962	1963	1964
Investment	805	1,017	1,217	1,482	1,617
Savings	2,406	3,101	3,358	3,738	4,178
Application of savings	2,174	2,882	3,306	3,431	3,788
Currency & demand deposit	441	561	533	691	721
Savings deposits	905	960	1,152	1,478	1,807
Insurance & money in trust	[illegible]	999	588	530	605
Bank debentures	[illegible]	27	74	103	144
Stock	190	423	369	344	390
Mutual funds	257	513	95	57	24
Others	23	15	45	21	47

Source: Ministry of Finance.

Table IX   Outstanding amount of monetary assets (Individual)

(Billions of yen)

	1960	1961	1962	1963	196
Cash & demand deposit (A)	2,638	3,199	3,700	4,365	5,0
A/D (%)	21.6	21.2	20.9	20.7	20.
Savings deposit & others (B)	7,255	8,608	10,122	12,124	14,5
Savings deposit	5,622	6,582	7,628	9,106	10,9
Money in trust	384	492	636	836	1,1
Insurance	1,250	1,535	1,858	2,182	2,5
B/D (%)	59.5	57.0	57.1	57.5	58.
Securities investment (C)	2,308	3,283	3,896	4,609	5,3
Bank debenture	202	223	303	406	5
Stock	1,404	1,820	2,209	2,723	3,1
Mutual funds	550	1,063	1,158	1,215	1,2
Others	152	170	226	265	3
C/D (%)	18.9	21.8	22.0	21.8	21.
Total (D)	12,201	15,090	17,717	21,097	24,9
%	100	100	100	100	1
Personal disposable income	10,345	12,173	13,876	15,860	17,9
D/E (%)	117.9	124.0	127.7	133.0	138.

Source: The Bank of Japan

FINANCIAL INTERMEDIARIES

The foregoing discussion gave some indications of the demand for and supply of funds of the financial intermediaries. Table X gives the relative importance of all categories of intermediaries at the end of 1960 and 1964.

Banks

There are 77 ordinary banks (13 city and 64 local banks) and 7 trust banks whose operations correspond to those of commercial banks in the United States. Japan has a so called "mixed banking system" and these banks are engaged in medium- and long-term lendings. They are a significant factor in the market for corporate, Government and municipal bonds. They also hold stocks of private concerns other than banks. Approximately 70 percent of their funds for loans and investments come from demand and time deposits (time deposits of more than three months account for half of the total deposit). Their own internal funds (capital and reserves) are as low as 6 percent. Borrowings including loans from the Bank of Japan and call loan, on the other hand, increased steadily in the post war period reflecting a great demand for investment funds. It reached as high as 15 percent of total assets when money was tight and it was 9.4 percent at the end of 1965. Supplementing these banks are a number of special banks and financial institutions that provide capital to industry.

The Japan Development Bank, a government owned bank, is the largest supplier of long-term loans to industry. The bank does not accept deposits but it borrows from government or international agencies such as the World Bank and it raises funds through bonds issue in the foreign market. In turn, it extends and guarantees loans and subscribes to corporate debentures. As of January 31, 1967, outstanding loans of the bank totaled 1,053 billion yen of which electric power, ocean shipping and coal mining accounted for 32.6, 32.5 and 7.2 percent, respectively.

Other government owned financial institutions are the Export Import Bank of Japan, The Small Business Corporation, The Housing Loan Corporation, The Agriculture, Forestry and Fisheries Finance Corporation and three relatively small corporations.

There are also three private long-term credit banks that derive more than 75 percent of their funds from the proceeds of the sale of debentures. These banks may issue debentures up to 20 times their capital and reserves. Of outstanding loan amounting to 2,639 billion yen as of January 31, 1967, 2,151 billion yen were loaned as equipment funds. Other financial institutions, mainly engaged in making small loans to business and cooperatives, include mutual loan and savings banks and various credit associations.

Table A   Financial intermediaries, Principal use and source of funds

(Billions of yen)

Use: Loans and securities investments

	1961	%	1965	%
Banks	9,559	55.9	19,340	52.6
(City banks)	5,487	32.1	11,043	30.1
(Local banks)	2,782	16.3	5,589	15.2
(Long term credit banks)	1,004	5.9	2,069	5.6
(Trust banks)	287	1.7	638	1.7
Financial institutions for small business	2,156	12.6	5,722	15.6
(Mutual loan & savings banks)	1,014	5.9	2,452	6.7
(Credit banks)	833	4.9	2,316	6.3
(Credit association)	154	1.0	496	1.4
Agricultural cooperative assoc.	907	5.3	2,221	6.0
Insurance companies (2)	720	4.2	1,692	4.6
Trust accounts (3)	738	4.3	1,839	5.0
Government institutions (4)	3,012	17.6	5,926	16.1
Total	17,093	100.0	36,739	100.0

Source: Deposits (1)

	1961	%	1965	%
Banks	8,093	55.8	16,084	51.4
(City banks)	4,265	29.4	8,171	26.1
(Local banks)	2,638	18.2	5,383	17.2
(Long-term credit banks)	955	6.6	1,978	6.3
(Trust banks)	235	1.6	547	1.7
Financial institutions for small business	2,401	16.6	6,155	19.6
(Mutual loan and saving banks)	1,037	7.1	2,518	8.0
(Credit banks)	945	6.5	2,574	8.2
(Credit association)	188	1.3	613	2.0
Agricultural cooperative assoc.	996	6.9	2,551	8.1
Insurance companies (2)	548	3.8	1,384	4.4
Trust accounts (3)	643	4.4	1,855	5.9
Government institutions (4)	1,828	12.6	3,290	10.5
Total	14,510	100.0	31,320	100.0

Note (1) Deposits include demand deposit, savings deposit, money in trust, insurance payment and bank debentures.
(2) Use of fund includes both life and non-life but source of fund includes only life insurance.
(3) Exclude trust fund for mutual fund companies.
(4) Use does not incluse government bonds. Source includes postal savings, postal pension and postal insurance.

Source: The Bank of Japan

Insurance companies

Table XI and XII show the investments of both life and non-life insurance companies. Life insurance companies place about 63 percent of their assets in mortgage loans. The second most important type of investment for them is common stock. In Japan life insurance companies can invest in stock up to 30 percent of total assets. Corporate and public bonds occupy only 11 percent of total securities investment. Non-life insurance companies, on the other hand, devote a substantial portion of their resources to purchase of securities, mainly in common stock.

Table XI Principal assets of life insurance companies (20 companies)

(Billions of Yen)

	1960	1961	1962	1963	1964	1965
Loans	464	586	736	913	1,134	1,334
Call loans	9	11	11	16	17	22
Securities	185	232	285	351	427	489
(Shares)	(171)	(212)	(263)	(318)	(376)	(437)
Total including Others	753	953	1,188	1,473	1,820	2,123

Source: "Economic Statistics of Japan" The Bank of Japan

Table XII Principal assets of non-life insurance companies (20 companies)

(Billions of Yen)

	1960	1961	1962	1963	1964	1965
Loans	32	39	45	52	65	65
Call loans	4	2	5	10	13	18
Securities	93	111	127	149	172	186
(Shares)	(82)	(99)	(112)	(128)	(145)	(153)
Total including Others	216	252	290	347	416	465

Source: "Economic Statistics of Japan" The Bank of Japan

Mutual funds (Investment trust)

The leading Japanese securities companies had all actively engaged in the mutual funds business until 1969 when they were advised by the Government to separate the fund management companies. At the present time, there are ten management companies whose combined assets exceed 1,000 billion yen. Leading securities companies which relinquished the function as fund managers are still active as sales agents of affiliated management companies. There are basically two different types of mutual funds. The semi-closed end type and open-end type fund. The semi-closed end type funds are established in series almost every month and each fund is managed independently. The general plan is for a management company to set up a fund in a contract with a trustee firm (trust bank). The management companies issues beneficial certificates (shares) to investors and they manage the portfolio. The duration or life of this fund is five years but investors can sell shares to designated securities firms before the maturity date at a price based on the current average prices of the securities in the fund. The open end type fund has, unlike semi-closed type fund, no maturity and additions can be made to the principal. After the initial offering, transactions are made on the basis of the average current prices of securities in the portfolios. As of the end of 1966, there were approximately one hundred separate semi-closed end funds (managed by sixteen companies) and forty-one open-end funds (managed by fifteen companies) including five funds which are specialized in bond investment. There is no closed-end fund in Japan.

From the start of mutual funds in 1951 to mid 1964, subscriptions increased year after year. The total amount of outstanding principal increased from 59.5 billion yen in 1955 to 1,432.3 billion yen in July 1964, an approximate increase of 23 times within nine years. Since mid-1964, however, the industry has been witnessing a continuous decrease in principal amounts as shown in table XII. Cancellations increased especially in 1965 mainly because of poor performance, resulting from a sharp decline in the stock market.

Mutual funds have altered their portfolio management policy since the stock market decline in 1964. During the period of rapid expansion, the policy was quite equity-minded and aggressive. For example in 1963 equity holding was 73.5 percent of total investments at book value. At the end of 1965 it stood at 50 percent.

As table XIV indicates, mutual funds played an important role in the expansion of stock ownership and it has been invaluable in the development of the contemporary capital markets of Japan.

Table XIII Principal and net assets of mutual funds

(Billions of Yen)

	1961	1962	1963	1964	1965	1966
(In principal amount						
Net subscription	833	431	442	452	317	291
Cancellation and Redemption	244	336	345	384	460	369
Outstanding amount	1,183	1,263	1,342	1,371	1,186	1,033
Net change	579	80	79	29	-185	-153
Net asset value	1,275	1,309	1,361	1,353	1,129	996

Source: The Investment Trust Association

Table XIV Mutual fund investments

(Millions of yen)

	Balance sheet assets as of February 1967	%
Cash	134	-
Call loan	152,704	15.3
Common shares (Book value)	492,304	49.2
(Market value)	(515,767)	-
Bonds and debentures	338,469	33.8
Other investments	16,768	1.7
Total	1,000,379	100.0

Source: The Investment Trust Association

Table XV Mutual funds in relation to the capital market
(Billions of Yen)

End of Year	Market value of stock in portfolio A	Aggregate market value, of listed stock (All stock exchanges) B	A/B %	Book value of bonds in Portfolio C	Out-standing amount of bonds* D	
1956	68	1,826	3.7	2	798	0
1957	91	1,717	5.3	5	959	0
1958	190	2,604	7.3	5	1,223	0
1959	309	3,820	8.1	14	1,623	0
1960	622	5,828	10.7	51	2,128	2
1961	771	6,965	11.1	316	2,901	10
1962	857	7,882	10.9	243	3,528	6
1963	809	7,498	10.8	200	4,372	4
1964	785	8,410	9.3	234	5,276	4
1965	690	9,393	7.3	273	6,666	4

* Corporate bonds and bank debenture.

Source: "Annual Report of Investment Trust" The Investment Trust Association.

SECTION IV - INSTITUTIONAL STRUCTURE

STOCK MARKET

The 1948 securities exchange law was patterned largely on the United States Securities Act of 1933 and the Securities Exchange Act of 1934. The law requires issuing companies to make public their financial condition in registration statements and also provides for registration and control of securities dealers and exchanges. Changes that marked a distinct departure from prewar practice include the conversion of the stock exchange from corporate organization to membership organization and ended the handling of securities transactions by banks so that this function is now handled exclusively by the securities companies.

There are nine stock exchanges in Japan, with about 70 percent of the trading conducted on the Tokyo Stock Exchange. As of the end of 1966, 1,615 issues were listed on nine stock exchanges and the total market value of these shares was 9,736 billion yen. In 1966 the average daily volume of the Tokyo Stock Exchanges was 121 million shares. All stocks traded are common stock and the par value of the majority of stock is 50 yen. Since new stocks are usually allotted to shareholders at par value rather than issued at the price near the market price, the par value has significance and this traditional pricing practice keeps average market price relatively low. The average share price (Jan., 67) of the 678 issues listed on the First Section of the Tokvo Stock Exchange was approximately ¥120 (The First Section is for larger seasoned, widely-held companies). A round lot is 1,000 shares.

The Japanese securities firms (397 firms as of March 1967) operate in the capacities of brokers, dealers and agents for the purchase and sale of securities. They also act as underwriters and distributors of new publicly offered issues. Previously firms which met the legal requirements provided in securities echange law could start securities business after registering with Ministry of Finance. In 1966, there were fundamental amendments to the securities exchange law, and at the present time securities firms have to be licensed by the Ministry of Finance after meeting stiffer financial and legal requirements. According to the amendments, there are also three kinds of license, namely, broker's license, dealer's license and underwriter's license. Large firms can obtain all these licenses but firms with smaller capitalization have to be specialized in one of these three fields.

Only joint stock companies are permitted to be securities firms, and banks and other similar financial institution may not engage in the securities business except the underwriting of Government and municipal bonds.

BOND MARKET

Trading in bonds on both the organized exchanges and the over-the-counter market is quite inactive in Japan as banks and other financial institutions constitute the largest purchasers, accounting for more than 80 percent of the total issues. Banks tend to regard bond investment as a different form of loan and purchase bonds of their client companies. They can also use bonds as collateral for loans from the Central Bank. Banks, in practice, hold such bonds in registered form until maturity, rarely unloading them for sale. The other basic reasons for inactivity in bond trading are the fixed issue rate of bonds and the disproportionate rate of interest on short and long term money. For example, yield of newly issued corporate bonds are fixed by the Government at six different rates in the range of from 7.408 to 7.92 depending on the rating of the bonds. The call money rates, on the other hand, fluctuate freely reflecting monetary conditions. In the tight money period of the past, call money rates, most of time, exceeded the yield of newly issued bonds. Lack of variety of bonds also contribute to the unpopularity of bonds. Almost all bonds are general mortgage straight debt which have 7 year life with the exception of bank debentures and some Government guaranteed issue. With start of floatation of Government bonds, the Government has been enforcing an easy money policy. As a result, Securities firms are succeeding in selling more bonds to the investing public and they now make markets for selected issues. The first international type convertible debenture was introduced in 1966 adding some variety to the bonds market. The Japanese bond market, however, may be the weakest part of Japan's capital market.

Table XVI Current terms of issue for bonds and debentures (As of Dec. 1966)

Bonds and debentures		Coupon rate (%)	Issue Price (per ¥100)	Maturity	Yield to investo[r] (annual %)
Government bonds		6.5	¥ 98.60	7 yrs.	6.795
Short-term Gov.bill(discount)		-	99.07	60 days	5.807
Municipal bonds		7.3	99.75	7 yrs.	7.354
Gov't guaranteed bonds		7.0	99.75	7 yrs.	7.053
Corporate Bonds	A	7.3	99.50	7 yrs.	7.408
	A'	7.3	99.00	7 yrs.	7,518
	B	7.3	98.75	7 yrs.	7.573
	C	7.5	99.00	7 yrs.	7.720
	D	7.5	98.50	7 yrs.	7.831
Bank debentures					
Interest-bearing		7.2	100.00	5 yrs.	7.200
Interest-bearing		6.8	100.00	3 yrs.	6.800
Pre-discounted		-	94.32	1 yr.	6.022

(Average yields as of Dec. 1966)

Gov. bonds	6,795 %
Corporate bonds	7,490
Stocks listed on Tokyo Stock Exchange	4,530

Table XVII Interest rate schedule in Japan

(1) Current interest rates on deposits.[1] (as of Dec. 1966)

		Percent
Bank rates		
Time deposits	3 months	4.00
	6 months	5.00
	1 year	5.50
Installment savings		3.90
Ordinary deposits		0.60
Deposits on notice		0.70
Deposits for tax payment		0.80
Other deposits		0.70
Trust bank rates		
Provisional dividend rates on money in trust	1 year or more	5.50
	2 years or more	6.20
	5 years or more	6.98
Provisional dividend rates on loan trust	2 years or more	6.35
	5 years or more	7.22
Postal savings rates		
Ordinary savings		3.60
Collection savings		4.08
Savings certificates	1 year or less	4.20
	more than 1 year	4.70
	more than 1 and half years	5.00
	more than 2 years	5.50
Term savings		5.00

(2) Average interest rates on loans and discounts

	Percent
Loans	
City banks	6.98
Local banks	7.67
Trust banks	7.32
Long-term credit banks	8.57
Discount	
City banks	6.96
Local banks	7.64
Trust banks	6.73
Long-term credit banks	6.32
Call money rates	
Overnight	5.48
Unconditional	5.84
Over-month-end	6.57

Note 1. The interest rates of banks and the trust dividend rates shown in the table represent the legal rates stipulated in the Ministry of Finance Notification under the Temporary Money Rates Adjustment Law and these rates are identical to the current rates.

TAXATION

Present tax provisions significantly affecting securities market decisions are summarized as follows:

Personal

Under the present Japanese tax legislation, both interest income and dividend income are subject to a withholding tax of 20 percent of the gross and the rest must be included as a part of taxable income for the purposes of the personal income tax. The individual taxpayer is then allowed, in the case of dividend to reduce income tax by 15 percent of dividend income (7.5 percent of dividend income in excess of 10 million yen). Interest income, on the other hand, is not taxable if principal amount (source of interest) is less than 1 million yen.

In order to encourage individual savings, however, Government enacted the special legislation which is renewable every two years. The legislation now in effect provides the following special treatments with option to investors.

1. Interest income is subject only to withholding tax at a rate of 15 percent. It is not necessary for individual to include interest income after withholding tax to taxable income.
2. The rates of withholding with respect to dividend income are 15 percent if annual dividend income from one company is less than 50,000 yen and 20 percent if it is less than 500,000 yen. Dividends income after deduction of such withholding taxes is non-taxable.

In Japan traditionally interest income has been treated favorably in personal income tax schedules. There is no provision in the lax legislation about capital gains. Capital gains of individual investors, therefore, are deemed to be non-taxable and capital loss is not tax deductible.

Corporation

Corporate earnings composed of dividends from invested capital may be excluded from income if dividends received does not exceed the dividend paid by the company to shareholders. If dividend received exceed dividend paid, only 25 percent of the excess will be included in their tax base. Capital gains are subject to the corporate income tax.

At the present time, the standard rate of the corporate income tax is 35 percent. The income to be paid as dividend is taxed at a reduced rate of 26 percent. But effective tax rate including local taxes will be on the average 47 percent. In view of the low equity ratio of Japanese companies, Government enacted special legislation to encourage the improvement of the equity to debt ratio. Effective from April 1, 1966, Companies which improve equity ratio can get tax reduction in the amount which directly relates to the ratio of improvement.

Taxes on operations in securities

Issuers of new shares and convertible bonds are subject to registration tax amounting to 0.7 percent and 0.15 percent of the nominal value respectively. Settlement of mortgage and registration of trust indenture for mortgaged bond issues are also subject to registration tax at a rate of 0.15 percent. Transfers in the ownership of outstanding securities are subject to a transfer tax at a rate of 0.15 percent.

CONTROLS INFLUENCING SAVINGS AND INVESTMENT

Credit controls

Three types of monetary controls are commonly employed in Japan. Corporate investments heavily rely on bank loans and banks in turn rely on the discount and advances from the Bank of Japan. Discount policy therefore has been a most effective and important monetary policy. Punitive high interest on excess borrowing from the Bank of Japan and moral suasion was frequently used to supplement discount policy. A reserve system whereby banks are required to maintain a certain reserve was first introduced in 1959 but variations in the required reserve have been infrequent. Until recently, open market operations were made on a small scale. However, the authorities are making efforts to employ open market operations in a larger scale and in a more effective way as a result of Government bonds floatations. The formulation, direction and supervision of such policies are carried out by the Policy Board, composed of the Governor of the Bank of Japan, two representatives of the government, and four members with experience in the fields of banking and industry. Further the Policy Board determines ceilings on interest rates of bank loans and bank deposits. Changes of the ceilings are to be initiated by Minister of Finance. At the present time, there is an interbank agreement to change the prime rate in accordance with changes in the rediscount rate of the Bank of Japan.

Security market controls

Securities issues in Japan are subject to varying degrees of control.

Stock issue

Prospective issuers must submit a prospectus to the Ministry of Finance, giving extensive information that purchasers should know before purchase. Issuing companies have to report beforehand its intention of capital increase to a Capital Issue Committee composed of representatives of financial circles. Since the stock market slump in 1965, which is largely related to excessive capital issues, the Committee set up temporarily a criteria for eligible candidates for stock issues. A company with better financial records is given priority of stock issue.

Listing application is made to the listing department of the stock exchange. The result of the examination of the application is submitted to the listing committee which requests management explanation for more detailed information on the economic and financial situation of the firm and also management policy. After the application is approved by the listing committee, the matter is brought to the Board of Governors of the exchange and then to the Ministry of Finance for final approval for listing. The major requirements for listing on the Tokyo Stock Exchange are: (1) paid-in capital of at least 300 million yen, (2) a minimum of 400 shareholders, (3) a record of operation of three years or more, and (4) good prospects of paying and maintaining 10 percent (of paid-in capital) dividend in the future.

Bond issue

The monetary authorities control the issue term of debt securities as a part of a general system of control over interest rates and maturities. In the case of corporate bonds, the rating of issuers is determined by Bond Issue Committee composed of banks and bond underwriters (securities companies) based on three factors viz: paid in capital, net worth and the outstanding amount of bonds. The rating automatically determines coupon rate and issuing price and it also has an important bearing on the amount to be issued during a fiscal year. Total volume of corporate bond issue are also determined before the new fiscal year starts by the representative of banks and securities companies after they consider the Government's schedule of its bonds and the volume of municial bonds approved by the Autonomy Agency. As banks absorb a substantial part of new bonds issues, the total amount of issue is very much related to cash position of banks. Banks are most influencial in the determination of ratings and the allocation of quotas in the amount of issues.

ISSUE METHODS

There are three principal methods of issuing securities on the Japanese security market namely the underwritten issue, the sale by agent basis and a rights offering. Most corporate bonds are underwritten by a syndicate composed of securities companies. One of the four large securities companies usually manage the issue and the composition of the underwriting syndicates change very little from issue to issue. As explained before, most of the corporate bonds are placed among financial institutions. Bank debentures are sold for public subscription on a continuous sales basis for which securities companies act as agent. Mutual funds are also sold by securities companies on an agent basis.

As far as an equity issue is concerned, there has been the traditional practice of allotting pre-emptive subscription rights for new shares priced at par to shareholders. During the period of rapid economic growth, many Japanese industrial companies expanded their production facilities on borrowed money and repaid the borrowings later on with proceeds of a rights offering to shareholders. When money was tight and no bank credit was available, they were compelled to make rights issue. No matter how poor the general market conditions were and no matter how uncertain companies earning prospects were they could affect rights offerings if their stock was selling above par.

Shareholders, on the other hand, could not sell their subscription rights. In order to recover the ex-rights depreciation in the price of their old shares, they had to subscribe for new shares, even at such times when they did not have money at hand. In addition, rights offerings do not require any underwriting by securities companies. Accordingly there is no way that securities companies car screen capital increases in the light of market conditions. The market slump in the past several years was largely related to such an excess of capital increases.

SECURITIES MARKET REFORM

In 1965, the Securities Bureau of the Ministry of Finance was reinforced and given more power to conduct securities market reform. Many committees were also formed by the securities industry with the participation of scholars and bankers to study the problems of financing economic expansion. One of the early results was that a rights trading market was established in 1966 and now shareholders can freely dispose of rights at market if they do not want to subscribe for new shares. The Securities Exchange Act was partially amended and securities firms now have to be licenced by the Ministry of Finance in order to continue their business. The main purpose of the licensing system was among other things to make securities firms more financially stable and reliable organizations under the closer guidance of the Government. During the period of a booming stock market, some brokers were often criticized for excess speculation. Government, under the licensing system also aims to watch the business practice of securities companies.

One of the most controversial issues in the discussion of capital market reform is on the stock issue method. Recently there is increasingly strong pressure for pricing new shares to be issued at close to market price. Opponents however consider that the issuance of new shares at market price will betray shareholders' expectations and lead to a sharp decline in stock prices because shareholders are holding shares with the expectation that companies will allot new shares at par, which is in most cases, at a big discount from market price. The proponents are pointing out the following merits to the new practice.

(1) The embarrassing over-supply condition of shares will be eliminated.
(2) The debt-equity ratio will improve and the cost of capital for issuing companies can be lowered.
(3) The tendency of earnings per share to decrease will be prevented.
(4) The stock market can function as a regulatory factor

in adjusting the amount of stock offering.
(5) Corporate managers will tend to pay more attention to the interests of shareholders.

The security industry recently proposed gradual adoption of the practice of offering stocks at close to market price with the conditions that (1) issuers notify its intention well in advance of the offering (2) shareholders be given priority to subscribe and (3) careful considerations be made in order to protect shareholder's interest.

Discussion on bond market reform and on efficient stock market practices are also underway. Various reform plans will be materialized one by one through the joint efforts of Government and industry within a few years.

Stock pooling organization

In order to stop the continuous slide of stock prices in the recession period of 1963 and 1964, two stock pooling organizations were set up in early 1964 and in 1965. Both organizations received a huge loan from the Bank of Japan and shelved floating shares in the market and shares in mutual fund portfolios.

Japan Joint Securities Corporation (JJSC) was organized through the sponsorship of 119 financial institutions including commercial banks, long-term credit banks, insurance companies as well as securities firms. JJSC bought stocks of 220 companies amounting to 198 billion yen at purchase cost which was approximately 3 percent of the aggregate market value of listed shares on the Tokyo Stock Exchange as of the end of 1964.

The Japan Securities Holding Association (JSHA) was set up in 1965 by securities companies. The association obtained loans of 230 billion yen from the Bank of Japan and most of the loans were used to shelve shares held by mutual funds, thus relieving them and the market from the financial burden associated with a large amount of cancellation of contracts.

In the recovery process of the stock market, both organizations gradually unloaded their holdings but they still hold approximately 80 percent of the total initial investments. Existence of the huge amount of shelved stocks is the biggest obstacle to stock market reform; it apparently prevents the free functioning of market mechanism. Dissolution of these organizations may be a prerequisite of capital market reform and it is a problem which is in urgent need of solution.

Akira Shimizu

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